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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission
DOCKETED
FEB 29 2012
DOCKETED BY

GARY PIERCE, Chairman
BOB STUMP
SANDRA KENNEDY
PAUL NEWMAN
BRENDA BURNS

IN THE MATTER OF THE APPLICATION OF ARIZONA PUBLIC SERVICE COMPANY FOR A HEARING TO DETERMINE THE FAIR VALUE OF THE UTILITY PROPERTY OF THE COMPANY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN.

DOCKET NO. E-01345A-11-0224

SOUTHWEST ENERGY EFFICIENCY PROJECT'S OPENING BRIEF

The Southwest Energy Efficiency Project ("SWEEP") submits the following Opening Brief.

The Southwest Energy Efficiency Project (SWEEP) is in partial opposition to the proposed settlement. SWEEP participated fully in the settlement discussions, which were open, transparent, and inclusive of all parties to this Docket who desired to participate. While there is a lot to like in the proposed Agreement, the Agreement falls short in several areas. The primary reasons that SWEEP is in partial opposition are: (1) the Agreement limits the Commission's options and flexibility for addressing utility financial disincentives to energy efficiency; (2) full revenue decoupling was not included in the Settlement Agreement, not even as an option for Commission consideration as part of its review of the Agreement; and (3) the energy efficiency performance incentive for APS should be addressed in the Energy Efficiency Implementation Plan process rather than in this rate case. (Schlegel direct testimony in partial opposition to settlement; Schlegel oral testimony, January 31, 2012.)

Several questions from the Commissioners are addressed at the end of this brief.

1. The proposed Settlement Agreement limits the Commission from fully exploring the policy options for addressing utility financial disincentives to energy efficiency, including limiting the Commission's consideration of full revenue decoupling.

The Commission is limited in two ways at two different times:

- Now, in considering the Settlement, the full range of options is limited in that some important policy options are not included; and
- Later, after the Settlement is approved (if approved), the Settlement limits the flexibility and options the Commission could consider when it considers changing its policies.

The proposed Agreement does not offer a framework for the Commission to thoroughly vet the policy issues surrounding both lost fixed cost revenue recovery and full revenue decoupling. Indeed, in any adoption of the full Settlement as filed, the Commission would not be able to consider full revenue decoupling at all — the very option that the Commission approved for the Southwest Gas Company in December 2011 after a thorough evaluation of evidence on both lost fixed cost revenue recovery and full revenue decoupling. Instead, the Commission would have to consider this option outside of the Agreement or as a substitute for LFCR. Accordingly, the proposed Settlement limits the Commission's ability to direct energy policy related to the treatment of utility financial disincentives to energy efficiency and is therefore not responsive to the concerns raised by Commissioners at the December 16, 2011 Special Open Meeting.

At the December 16th Open Meeting, several Commissioners expressed their concerns about settlements limiting their options and their flexibility, for example, related to the treatment of the line extension issue in the last APS settlement. In the current case, the Settlement is inconsistent in how it addresses Commissioner concerns regarding limitations on Commission options and flexibility. In the case of the energy efficiency programs and savings to reduce customer bills, the Settlement leaves these decisions up to the Commission. However, in the case of regulatory policies to address utility disincentives to energy efficiency, the Settlement limited the options that the Commission could consider in its review of the Settlement, by including only one option and excluding the other. In fact, if not for the partial opposition of SWEEP and NRDC, there would be no record in the Commission's review of the Settlement upon which the Commission would consider the option of full revenue decoupling.

2. Full revenue decoupling, a mechanism the Commission adopted in December 2011 in the Southwest Gas rate case after a thorough evaluation of all of the evidence, is a superior approach for the treatment of utility financial disincentives to energy efficiency compared to the Lost Fixed Cost Recovery (LFCR) mechanism proposed in the Settlement Agreement.

Full revenue decoupling is important not only for full, enthusiastic utility support of energy efficiency programs but also for activities that reduce energy bills including those not directly linked to the Company's portfolio of energy efficiency programs, such as utility support for building energy codes and appliance standards, broad energy education and marketing, state and local government energy conservation efforts, and federal energy policies.

Full revenue decoupling allows for bill adjustments in both a positive and negative direction, and therefore decoupling could result in either a credit (e.g., as sales increase as the economy recovers) or a charge on the customer bill. In contrast, the proposed LFCR mechanism represents an automatic rate increase. Further, the LFCR mechanism does not provide a credit when experienced revenues are higher than forecasted, such as when electricity sales increase because of an improved economy.

Also, the LFCR mechanism proposed in the Agreement does nothing to reduce APS' financial incentive to sell more electricity and encourage customers to use more electricity. Therefore the Settlement sends mixed signals, and LFCR does not adequately align APS' financial incentives with the interests of customers.

SWEEP supports full revenue decoupling, as proposed in the original APS application, but with the 3% cap as described in SWEEP's direct testimony. SWEEP proposes a 3% cap for decoupling adjustments, which would be a total cap on all decoupling adjustments (revenues relative to the revenue per customer level set in the rate case) in a year – i.e., no more than 3% total increase in any year relative to the authorized revenue per customer, no matter what. And with decoupling, any sales above the test year revenue per customer would become a credit to customers, which would offset any upwards adjustments.

3. The Commission should *substitute* full revenue decoupling in place of the LFCR mechanism proposed in the Settlement Agreement because full revenue decoupling more completely and effectively reduces utility company disincentives for the support of activities that eliminate energy waste and increase energy efficiency, while LFCR does not.

The Commission should decide this case in the same way it resolved the Southwest Gas case: approve the Settlement Agreement but substitute full revenue decoupling, as proposed in the original APS application but with the 3% cap as proposed in SWEEP's direct testimony, in place of the LFCR mechanism proposed in the Settlement Agreement. Full revenue decoupling more completely and effectively reduces utility company disincentives to energy efficiency, compared to the narrow LFCR mechanism. And full revenue decoupling better aligns the financial incentives of the Company with the interests of customers.

4. Rate case stay-out provisions can limit the Commission's ability to direct energy policy. The Commission should exercise caution when enacting a rate case stay-out provision, especially one as long as four years.

For example, the settlement agreement adopted in Tucson Electric Power's (TEP) 2008 rate case included a stay-out provision that prohibits the Company from filing a new general rate case application until mid-2012. As the Commission is fully aware, this stay-out provision has constrained Commission options and actions related to the achievement of the Energy Efficiency Standard (adopted in 2010) and the Commission's review of the TEP EE Implementation Plan, and may prevent or limit TEP customers from receiving the full value of energy efficiency investments including reduced utility bills.

If the Commission chooses to adopt the proposed Agreement, the Commission should shorten the stay-out period to three years. At the very least, in three years time or sooner the Commission should exercise its authority to initiate a systematic review to determine if rates are just and reasonable for customers and to determine whether the continuation of the stay-out provision is warranted.

5. Energy efficiency performance incentives are an important policy instrument that the Commission should use to influence and direct energy efficiency outcomes during the energy efficiency implementation plan process.

The APS performance incentive should be addressed in the EE Implementation Plan process rather than in this rate case (see Agreement subsections 9.14 (b) and (d)), and it should be addressed in a more timely manner. Specifically, the revised/improved performance incentive for 2013 should be developed by this summer, through a stakeholder process, rather than by December 2012 under the Settlement Agreement.

The Electric Energy Efficiency Standard Rule states that, "In the implementation plans required by R14-2-2405, an affected utility may propose for Commission review a performance incentive to assist in achieving the energy efficiency standard set forth in R14-2-2404. The Commission may also consider performance incentives in a general rate case" (R14-2-2411). The Electric Energy Efficiency Standard Rule allows for performance incentives to be proposed and adopted during a rate case *or* during the annual energy efficiency implementation plan process.

Performance incentives are an important policy instrument that the Commission should exercise to influence and direct energy efficiency programs and outcomes for the benefit of customers. To that end, it is critical for the Commission to be able to oversee and modify performance incentive design during the energy efficiency implementation plan process, when new energy efficiency programs and initiatives are proposed, reviewed, and approved by the Commission, and when energy efficiency policy is implemented.

Consistent with the arguments above, the new performance incentive should be developed by mid-2012, filed by APS as part of its 2013 EE Implementation Plan, and considered by the Commission as part of its review of the 2013 EE Implementation Plan. There is no reason for APS, Staff, and stakeholders to wait until December 2012 to complete the development of a new performance incentive that will better incent achievement of cost-effective energy savings, and that will address several of the issues raised by Commissioners in this and other proceedings, including a change in the performance incentive cap.

APS should voluntarily convene the stakeholder process now in order to develop a revised and improved EE performance incentive, and to include the revised performance incentive in its 2013 EE Implementation Plan.

6. The Commission should set objectives and design criteria for an energy efficiency performance incentive that establish a clear connection between the performance incentive level and the achievement of cost-effective energy savings to benefit customers.

The order in this case should include the SWEEP-recommended objectives and design criteria for an energy efficiency performance incentive that establish a clear connection between the performance incentive level and the achievement of cost-effective energy savings to benefit customers (see Schlegel settlement testimony, pages 8-9).

7. Energy efficiency, as a fundamental resource meeting the real energy needs of customers at lowest cost, should be adequately funded in base rates at stable levels.

In order to provide adequate treatment for this central and least cost resource, total funding of $70 million for energy efficiency should be expensed in base rates, while commensurately reducing the DSM adjustor.[1] Since $10 million of energy efficiency funding is already expensed in base rates, a $60 million increase would be needed. The DSM adjustment mechanism should still remain intact, but should recover or refund any energy efficiency funding amounts above or below $70 million, as needed to implement and deliver energy efficiency offerings to customers. In this way, the DSM adjustment mechanism would serve as a flexible means of recovering additional energy efficiency funding (as needed). For example, based upon the Commission Staff's Second Revised Report and Recommended Order on APS' 2012 DSM Implementation Plan, SWEEP estimates that expensing $70 million of energy efficiency program

[1] As summarized in SWEEP's direct testimony, in the APS 2012 DSM Implementation Plan, the Company proposed to spend $78 million, while delivering $194 million in net benefits to customers. Hence, expensing $70 million in base rates would equate to approximately 90% of these anticipated funds.

costs in base rates would reduce the total amount collected through the 2012 DSM adjustor for 2012 energy efficiency programs (not including demand response costs) from $71.4 million[2] to $1.4 million, reducing the DSM adjustor for 2012 energy efficiency programs from about $0.0022 per kWh[3] to $0.000052 per kWh.

8. The impacts of Commission-adopted policies should be reflected and accounted for in adjustments to test year sales used to set rates.

If the rate setting process does not account for Commission-adopted policies, a disconnect arises between ratemaking and the very policies themselves. This disconnect can lead to regulatory lag, mismatches between cost causation and cost recovery, and the under-recovery of authorized fixed costs. The Commission should approve rates that are adequate in recovering Commission-authorized costs within the same time period in a manner that is consistent with the effects of Commission-adopted policies.

Specifically, the impacts of Commission-adopted policies should be reflected and accounted for in the test year sales used to set rates. A post-test year adjustment to sales (which would impact revenues) should be applied to test year sales, to account for the energy savings and load-reducing effects of the Commission-adopted Electric Energy Efficiency Standard requirements. The Electric Energy Efficiency Standard requirements and their impacts on sales are known and measurable. Further, applying the post-test year adjustment would result in better and more accurate alignment of revenues and expenses based on these known and measurable quantities. If the Commission is concerned whether a full 100% of the Electric Energy Efficiency Standard requirement would be met in each and every year, the post-test year

[2] The $71.4 million amount includes the cost of 2012 energy efficiency programs; the cost of the proposed Codes and Standards program; measurement, evaluation, and research; and the energy efficiency performance incentive.
[3] This value accounts for the $10 million in energy efficiency funds already expensed in base rates.

adjustment could be applied at a level of 75% of the Electric Energy Efficiency Standard requirement.

Questions from the Commissioners

Below are several questions from Commissioners, with a summary of the responses that SWEEP witness Jeff Schlegel provided during oral testimony on January 31, 2012.

1. Should we address the EE performance incentives in the EE Implementation Plan process rather than in this rate case through the Settlement Agreement?

Yes. It is critical for the Commission to be able to oversee and modify performance incentive design during the energy efficiency implementation plan process, when new energy efficiency programs and initiatives are proposed, reviewed, and approved by the Commission, and when energy efficiency policy is implemented. (Schlegel oral testimony, January 31, 2012.)

The new performance incentive should be developed by mid-2012 through a stakeholder process, filed by APS as part of its 2013 EE Implementation Plan, and considered by the Commission as part of its review of the 2013 EE Implementation Plan.

APS should voluntarily convene the stakeholder process now in order to develop a revised and improved EE performance incentive.

If necessary and if desired by the Commission, the Commission should order in this rate case that the proceeding shall remain open in order to review/approve the EE performance incentive developed in the 2013 EE Implementation Plan process (the APS 2013 EE Implementation Plan is to be filed in June 2012).

2. Should Section 9.14 of the Agreement on EE performance incentives be removed?

Section 9.14 should be revised, but not eliminated. The Commission should provide some direction in the Commission's order, i.e., include the SWEEP-recommended objectives and design criteria for an energy efficiency performance incentive, and require APS and the stakeholders to address several of the issues and questions raised by Commissioners in this and other proceedings, including a change in the performance incentive cap.

3. Regarding the two columns in the existing performance incentive, as shown in the table in Section 9.14(b), what is the purpose of the column on the right (the cap as a % of program costs), how does it work, and does it provide an incentive to spend more money?

The column on the right shows the cap on the performance incentive amount, expressed at a percent of program costs. The origin of the incentive cap is that a cap was desired by Commissioners, and program costs are better known and understood at the time of the review of an EE Plan than net benefits, therefore a cap set as a percent of program costs is a clear and known value at the time of EE Plan approval.

SWEEP has heard individual Commissioners raise questions about whether the incentive cap provides an incentive for APS to spend more money on EE programs. SWEEP understands this concern, though we believe it is a relatively small problem and only at the margin. That said, SWEEP supports a revision of the incentive cap. SWEEP proposed a revised cap for the performance incentive in SWEEP's Settlement Testimony, page 9, lines 37-40.

4. In the performance incentive table, what would happen if you delete the column on the right (the cap as a percent of program costs)?

It is a good idea to *replace* the current cap with a better cap, one that addresses the concerns. However, it is not a good idea to *delete* the cap entirely, because it would lead to higher and uncapped performance incentive earnings for APS.

Therefore the best solution is to develop a better cap. Again, see the SWEEP-proposed cap for the performance incentive, in SWEEP's Settlement Testimony, page 9, lines 37-40, for a proposed alternate cap.

5. If there was a non-utility administrator of EE programs in the APS service territory, would a performance incentive still be needed?

Yes, a performance incentive is an important policy tool that the Commission should use to influence and direct energy efficiency outcomes – regardless of whether there is a utility or non-utility administrator of EE programs. In Vermont, there is a non-utility administrator and there is a performance-based incentive for the administrator.

6. Should the LFCR be added into the DSM adjustor mechanism?

No. These lost fixed cost revenues are not a cost of energy efficiency; they are a result of the rate-setting process and the Commission's policies. Also, doing so would make it more difficult for a customer to decide between the LFCR and the opt-out rate (how would a customer be able to tell the difference?).

7. Would it be more transparent to use one adjustor surcharge for EE and a separate surcharge for Distributed Generation?

Transparency and improved understanding are important objectives, but they should be addressed as part of the bill presentation process set forth in Section 16.1. Also, clear and transparent information for customers is important, but information and disclosure for customers should be done in an objective and fair manner across all resources, i.e., in a manner that does not disadvantage or bias the treatment for any one resource. The resources should be treated in a more consistent manner, and EE should not be singled out by disclosing separate funding for EE programs on the customer bill while not disclosing the costs and funding of other resources.

8. Which parties continued to participate in the settlement discussions, on what issues, even when it may have become apparent that the party may not ultimately support the final Agreement?

(See Guldner testimony in support of the Settlement Agreement, p. 9, lines 4-5.)

SWEEP continued to participate in the settlement discussions late into the process, and continued to make suggestions for the parties' consideration (for example, on issues such as the performance incentive and staff review of EE plans), in an effort to improve the settlement provisions and language, and to reduce the potential areas of dispute.

DATED this 29th day of February, 2012.

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All Parties of Record

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